[OVERVIEW] U.S. Industry Expected to Remain Stable with Some Downside Risks

- The U.S. economy is gradually increasing stability on the back of improving consumer spending and capital expenditures; real GDP increased 1.8% in the third quarter, followed by a 2.8% increase in the fourth quarter.
- Going forward, along with a moderate expansion of the U.S. economy, the business climate for the U.S. industries is anticipated to remain stable. Nevertheless, there are some downside risks: rising gasoline prices which may negatively impact consumer spending, and further deterioration of the European economy as well as slowing Asian and Latin American economies.

(The Outlook for Major Sectors and Indicators)

- **Energy**: Crude oil prices are expected to remain elevated on the back of growing emerging market demand and tight capacity. Natural gas prices are likely to remain weak due to booming shale gas production.
- **Materials**: Ethylene prices are expected to moderately rise attributable to planned maintenance shutdowns of crackers as customers rebuild inventories. Steel and aluminum prices are likely to remain sluggish due to excess supply.
- **Industrials**: Non-residential construction spending is showing signs of bottoming out. Machinery orders have recovered to the pre-recession level; going forward, growth in orders is likely to moderate except for construction and power generation segments.
- **Consumer discretionary/staples**: U.S. light vehicle sales forecast is 13.6-14.0 million units SAAR for full-year 2012, attributable to solid sales recovery driven by pent-up demand among other factors. Consumer discretionary retail sales are expected to grow at a slower rate. Meanwhile, sales volume in the consumer staples segment is anticipated to increase as inflationary pressure eases.
- **IT**: Growth in PC unit sales is likely to remain low as new devices such as tablets erode the PC market share and an enterprise refresh cycle comes to an end. Semiconductor shipment growth is expected to stay in the low single digit range for 2012, hampered by excess inventory offsetting moderate demand growth.
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Note: The "FORECAST" period added in this edition is a short-term outlook (6 months-1 year).
1. Offshore Rig Utilization/ Dayrates

**Forecast:** Ultra-deepwater to continue tightening, pulling floater class dayrates higher

- Utilization is tightening up in the floater market with limited availability of ultra-deepwater rigs, pulling dayrates higher. This is driven primarily by pre-salt activity in Brazil and West Africa. Deepwater and mid-water rigs are filling the gap in ultra-deepwater availability, keeping these markets tight as well.
- Floater (semisubmersible and drillship) fixtures are already back to levels above pre-Macondo and in the range of the prior up-cycle in 2006-2007.
- Jackup dayrate upside remains limited as the availability of capacity from the significant number of uncontracted newbuild deliveries still outweighs demand.
- Utilization is expected to tighten further in the floater market as elevated oil prices continue to drive deepwater spending. Jackup utilization will continue to face pressure from oversupply.
- Dayrates for floaters should continue to rise due to tightness in the ultra-deepwater market and limited availability of supply in the near-term. Capex spending in the upstream, focused on Brazil, West Africa and the deepwater Gulf of Mexico, should continue this trend. Jackup dayrates, however, will not gain much traction as the ample delivery schedule continues.

2. Crude Oil Prices and Demand / Natural Gas Prices and Storage

**Forecast:** Elevated Brent prices as natural gas pricing to continue to remain depressed

- WTI crude declined slightly in 2H/11, but rebounded significantly in 2012 as Brent and WTI prices have both made gains and continue to remain elevated. This is driven by demand growth and geopolitical tensions raising the uncertainty of supply in the face of low spare capacity. The WTI-Brent spread should remain wide, as solutions to alleviate the Cushing oversupply have been slow in coming.
- Oil prices are projected to continue to remain elevated as spare capacity remains tight and developing world demand continues to grow.
- Natural gas prices declined in 2H/11 and continued the decline in 2012 as oversupply continued to be driven by the shale gas boom and lack of demand growth.
- We expect natural gas prices to remain depressed as operators continue to drill under hedges, obtain financing through joint ventures and M&A, and perpetuate the production of associated gas from liquids-rich plays. However, some rationalization from recently announced reduction of capex spend for dry gas drilling could help to bring the market closer to equilibrium.
3. Ethylene Price

**Forecast:** Tight supply will help lift ethylene prices

- After peaking in May and June, ethylene prices declined through October, as demand softened on concerns over a potential contagion from the Eurozone debt crisis and on customer destocking and delaying of orders. Announcements of planned shutdowns pushed prices up in the closing weeks of last year.

- With ExxonMobil, Shell, Dow, LyondellBasell, CPChem, and BASF planning cracker maintenance shutdowns through April, ethylene supply will remain tight in the U.S. Crackers will continue to operate close to capacity, as customers restock their severely depleted inventories and producers seek to benefit from their cost-advantaged ethane-based feedstock. As a result, prices will continue to rise in the next 6 to 12 month, though their ascent will be modest. Ethylene volumes, according to a forecast by ACC (American Chemistry Council) will rise by a mere 1%.

4. Cardboard Box Shipments

**Forecast:** Box shipments to remain flat through mid-2012

- Growth in cardboard box shipments remained sluggish in H2/11 bringing the increase for the year as a whole down to 0.5% - which compares with 3.5% growth in 2010. The rise in containerboard inventories at the end of the year, putting stocks at a three-year high, was a further sign of demand weakness.

- Box shipments are expected to remain flat at least through mid-2012. This could put some pressure on pricing, although International Paper (IP), which has further enhanced its market-leading position with the acquisition of Temple-Inland, has thus far been able to keep prices from falling by reducing output to balance supply with demand.
Steel:
➢ From a demand standpoint, steel market conditions improved in late December into 2012 after lacklustre
4Q11. Nearly every major end-use market for the steel industry has shown signs of improvement, including
heavy equipment, aerospace and auto along with oil and gas. Steel production has kept a steady upwards
trend, marking an 8.7% YoY increase in December. This translated into domestic capacity utilization of
78% in late December, maintaining modest gains over a historic dip in 2009.
➢ US steel prices have risen since 4Q11 as more than $140 per ton of benchmark HRC price hikes have
stuck. However, the pace of business activity hit a February lull, and early January strength has already
reversed. Buyers now seem focused on excess supply concerns due to new capacity additions coming to the
market. Moreover, rising imports have become a threat to domestic prices as the U.S. price premium over the
world prices widened in recent weeks.

Aluminum:
➢ The U.S. aluminum industry is facing healthy demand recovery. Last year, service center shipments rose 15% YoY
to 1.5M tons. End customer demand has been improving from the aerospace, truck-trailer and auto
industries. However, aluminum prices remain under pressure in the near term, due to the weak global
economy and high LME inventories. LME inventories remain at record highs, reflecting over supply and the
prevalence of warehouse financing deals. In response, many aluminum producers have announced production
cutbacks and capacity closures.

Paper Price
➢ Total U.S. paper and paperboard production fell 1.8% in 2011. Newsprint (-4.8%) was the weakest of the
major paper grades, followed by uncoated free sheet (UFS, -3%). Containerboard recorded an increase, but
it was less than 1%. Pricing held up reasonably well in the weak environment. Quoted prices for both
containerboard and newsprint have held at current cycle highs for 18 months, although newsprint remains well
below previous peaks. In the UFS segment there has been some easing in reprographic paper pricing.
Supply discipline has been responsible for pricing firmness.
➢ Weak demand patterns are expected to persist for the next 6-12 months. The ability of leading producers to
keep pricing stable will be tested.
7. Non-Residential Construction Expenditure

**Forecast:** Growth in non-residential construction spending to accelerate

- Growth in U.S. non-residential construction spending in H2/11 was positive for the first time since H2/08, as 8.4% growth in private spending outweighed continued contraction (-7%) in the public sector. Power projects (+19%), manufacturing construction (+14%) and commercial building (+13%) were the leading sources of growth. There is still weakness in the healthcare, lodging and office building segments, but rates of decline have slowed markedly.

- The construction sector continues to exhibit signs of bottoming out. Public spending will likely be a drag for another 3-6 months, but state and local government tax revenues have stabilized and eventually municipalities will have to address the backlog of repairs and upgrades postponed while funds were tight. Growth in non-residential construction spending should accelerate in the second half of 2012.

8. Commercial Aircraft Orders and Backlog

**Forecast:** Commercial aircraft demand to remain strong

- New orders for commercial jet aircraft doubled in 2011, reaching their second highest level on record. Orders were twice as large as deliveries (which surpassed 1,000 units for the first time) and backlogs continued to rise. Worldwide demand for narrow-body aircraft is very strong as China and India seek to develop their airline infrastructure, while developed countries move to upgrade their fleets to increase fuel efficiency and to meet increasingly stringent environmental requirements. Airbus orders outpaced Boeing by the widest margin ever (76%) thanks to their 320neo narrow-body which offers superior fuel efficiency to the B737.

- Demand for commercial aircraft should remain strong over the intermediate term. High and rising fuel costs continue to drive airlines to accelerate planned fleet upgrades. Boeing and Airbus are ramping up production to capitalize on the surge in backlogs. It is not yet certain whether their suppliers will be able to support the targeted 20% increase in production.
9. Machinery Order

**Forecast:** Further moderation in growth likely

- Growth in machinery orders continued to decelerate in H2/11. The construction (+31%) and power generation (+29%) segments continued to be the primary drivers for industry growth. Machine tool orders (+11%) reversed a decline in the first half of the year. However, there were signs of more significant slowing in the industrial (-4%) and mining equipment (-4%) segments.

- Orders have now completely recovered from the steep decline recorded during the recession and moderation in growth rates is likely. There is still strong momentum in the construction and power generation equipment segments, which together account for 28% of total machinery orders. Caterpillar foresees continued strong growth in construction equipment demand throughout 2012. Electric utilities should continue to invest in plant upgrades and capacity expansion. However, slowing in other segments should bring average industry growth down to the 3-6% range.

10. Railroad Traffic

**Forecast:** Slow growth to continue

- Total railroad freight tonnage rose only 1.4% in H2/11, its weakest performance since the recovery got underway in early 2010. Slowing was experienced in all major sectors, including coal (flat), chemicals (+1.6%) and grain shipments (-12%). Growth in container shipments fell to 3.8% vs. +8.3% in H1/11. Motor vehicles (+12%) were one of the few bright spots.

- Slow growth in railroad ton-miles will likely remain in place over the next 6-12 months. Tonnage levels are now less than 1% below their previous high and future growth should be parallel to GDP expansion. Coal will likely continue to be a drag due to protracted low natural gas prices. Growth in intermodal demand should pick up now that import flows onto West Coast ports are beginning to improve.
11. Airline Revenue Passenger Miles

**Forecast:** Air traffic demand to stabilize but remain sluggish

- U.S. air traffic growth continued to slow in H2/11. Domestic traffic was flat as a 1% decline in legacy carrier (LC) traffic was offset by a 5% rise for low-cost carriers (LCC). Growth on international routes fell 1%. Despite the relatively weak demand performance, the industry successfully implemented numerous price increases throughout the year largely to counter the rise in fuel costs. Limited capacity growth has been the key to pricing power.

- Growth in air traffic is expected to stabilize but remain sluggish over the next 6-12 months. However, if jet fuel prices should return to their previous 2008 highs ($3.60/gallon) and airlines continue to pass these costs through to passengers, traffic growth would be weaker.

12. Automobile Sales / Production

**Forecast:** Demand continues to improve on the back of pent-up demand due to aging fleet

- U.S. light vehicle sales have been steadily improving, with full-year SAAR currently forecast at 13.6-14.0 million units this year, up from 12.7 million in 2011 and 11.6 million in 2010. Although strong fleet sales and warm weather are likely having some impact, many automakers are indicating strength in underlying demand. Much of the sales growth since late 2011 has been driven by improving consumer confidence and higher inventories at Japanese automakers. Going forward, we think pent-up demand due to an aging fleet and a rebound in leasing/credit availability will continue to drive solid sales recovery this year. Pricing remained strong with the average transaction price up 7% YoY in February, while incentives were down. This was despite some negative mix shift towards small cars on the back of rising gasoline prices.

- North American light vehicle production totaled 13.1 million in 2011, up 10% from a previous year. 2H11 levels were well above 1H levels as Japanese automakers rebounded strongly from the supply disruptions caused by the Japan earthquake in spring. According to some estimates, North American light vehicle production is expected to grow 6% YoY to 13.5-14.0 million units this year, up from 13.1 million in 2011 and 11.9 million in 2010. The increased production will be driven by capacity additions by foreign transplants and growing export opportunity outside North America, as well as regional market recovery. With Japanese and European automakers adding production capacity in North America, locally-built vehicles accounted for 78% of the total U.S. light vehicle sales in 2011, up from 74% in 2009 and 76% in 2010. This upward trend is expected to continue in the near term.
13. Ad Revenue Growth

**Forecast:** Political & Olympics boosts 2012

- Media buyers are currently forecasting healthy 2012 ad market growth. The average global forecast for 2012 is +5.5% vs. +4.6% for 2011. The average US forecast for 2012 is +3.8% vs. +2.3% for 2011.
- 2012 US estimates reflect the benefit of ad spending from the presidential elections, the Olympic games, a strong showing in auto ad spend and a continued focus on multi-nationals penetrating the emerging markets.
- We believe these estimates are reasonable assuming S&P 500 corporate earnings are up +9% this year as expected.
- We expect Internet advertising will continue to outperform the average as marketers continue to focus on adopting new technologies and digital initiatives (including social media and mobile).
- Online’s share gain should continue to come from print publishing (newspapers and magazines) which continue to lose audience as this business model for entertainment and information consumption continues to lose appeal (tablets could eventually help drive print consumption but it is too early to see benefits).
- Cable nets should also continue to outperform TV to reflect the benefit of growing audience size and more affordable pricing.

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14. Growth in Hotel Occupancy and Average Daily Room Rate (ADR)

**Forecast:** Occupancy growth to slow, but pricing to remain firm

- Hotel occupancy and pricing continued to improve in H2/11. Both occupancy and average daily room rates (ADR) rose 3.9% in the second half driving an increase of about 8% in revenue per room. The industry is benefiting from good growth in both leisure and business travel.
- Growth in occupancy is expected to slow over the next 6-12 months as high gasoline prices cut into consumers’ vacation budgets. Nevertheless, room utilization rates should remain sufficiently high to enable hotels to continue to raise prices, albeit at a slower rate of increase than over the last 1-2 years. There is still very little new hotel construction in the pipeline, which should provide further support to prices.
15. Consumer Discretionary Retailing
(Same Store Sales)

**Forecast:** As consumer sentiment improves, retail promotions show some signs of easing

- Comparable store sales in 4Q11 rose 4.2% for a select group of retailers. This compares to a 3.7% comp increase in 3Q11, but slightly below the 5.4% surge in 4Q10. The last year’s holiday season seemed to be somewhat negatively affected by unusually mild weather, which depressed sales of cold-weather items. And after retailers passed through higher raw-material costs in early 4Q, shoppers began to resist higher prices and the environment turned promotional later in the season. In the first two months of 2012, U.S. retailers delivered generally solid comp sales as improving economic conditions and warmer weather helped kick off spending of spring merchandise, sold at full-price.

- The high-end department stores continued to be the best performer, while the mid-tier department stores remained rather mixed due to market share shifts among major chains.

- As we move into 2012, retail sales on the whole are expected to increase, but likely at a slower rate than the last two years after a strong acceleration post recession. The National Retail Federation forecasts the retail industry sales growth of 3.4% this year, slightly lower than a 4.7% growth in 2011. Accordingly, retailers have been managing the business with one foot on the accelerator and one foot on the brake. They remain cautious with their inventory levels in order to maintain full-price selling and avoid heavy discounts.

16. Food & Staples Retailing
(Same Store Sales)

**Forecast:** Expect modest improvement

- Traditional supermarkets reported a 3.8% increase in same-store sales for 4Q11. The healthy rise in same-store sales was driven primarily by a pass-through of higher cost inflation as many supermarket chains reported increasing basket prices during the quarter. However, sales volumes (tonnage) declined as price-sensitive consumers resisted higher prices for food. Over the same period, the YoY change in personal expenditures on food at home moderated after peaking in 3Q11, even with food inflation of approximately 4.5% YoY.

- On the other hand, supercenters and warehouse clubs reported sustained sales strength, driven by strong customer traffic and improving demand in discretionary categories. The strong traffic could also indicate that these non-traditional players were taking market share in groceries.

- Drug stores’ same-store sales growth moderated in 4Q11 to 0.9%, down from 1.9% reported in 3Q11 and 1.5% in 4Q10. The moderation was primarily due to ongoing generic shift within pharmacy and lackluster front-end sales as the industry continued to deal with a historically weak flu season and generally weak consumer.
17. Electromedical, Measuring & Control Instrument Manufacturing (Medical Equipment)

**Forecast:** Shipments will return to modest growth

- Shipments declined in the second half of last year. Reduced utilization of healthcare services, along with tightened rules regarding the use of equipment, constrained governmental and commercial reimbursements and prompted hospitals to both reduce their purchases of medical equipment, especially big-ticket items, and extract price concessions from suppliers. The PPI of X-ray and electromedical equipment slid 1% YoY in the second half of last year.
- A scarcity of breakthrough products, on top of product recalls, also weighed on both shipments and prices.
- Against the background of receding unemployment, hospital utilization trends seem to have bottomed and will be further aided by the health demands of the aging population. This will prompt hospitals to cautiously start replacing their aging equipment, while also investing in products that help drive patient volumes. Continued demand from emerging markets will also help return shipments to modest growth.

The chart above refers to NAIC 3345, which includes not only electromedical and electrotherapeutic products but also laboratory analytical instruments, aeronautical instruments, navigation and guidance systems, and physical testing equipment.

18. Pharmaceutical Shipment

**Forecast:** Flat shipments amid an influx of generics and high-priced new drugs

- Pharmaceutical shipments posted YoY declines each month in the second half of last year, as several blockbuster drugs, including the world’s best-selling drug Lipitor, lost patent protection and opened floodgates to lower-priced, often imported, generic substitutes. Persistently high unemployment and third-party payers’ push of consumers into generics took a further toll on sales of branded medicines.
- The decline in the value of shipments would have been even steeper, were it not for a 4.1% increase in the PPI of drugs in the July-December period YoY. This growth was driven by the roll-out and market uptake of several high-priced medicines as well as by last year’s price hikes on some 165 brand-name prescription drugs, averaging 7.2%.
- In 2012, branded drugs totalling a record $35 billion will lose patent protection, and except for one blockbuster biologic (Enbrel), are at risk of being undercut by generics. Despite the coming generic onslaught, pharma shipments will likely be flat in 2012, reflecting the market entry of a large number of expensive new drugs. 35 innovative drugs won FDA approval last year, one of the highest numbers of approvals in the past decade, with several of them representing breakthrough medicines priced from $5,000 /month to $120,000/course of treatment.
19. Loan Growth and Credit Performance (Non-bank Financial Companies)

**Forecast:** Gradual improvement in loan growth and further decline in charge-offs

- **Companies have shifted from defense to offense.** After successfully navigating through the financial crisis, non-bank finance companies have shifted from capital preservation to growth. Although loan growth continues to decline on a year-over-year basis, the pace of decline has decelerated. Real estate lending, however, continues to lag.

- **Loan demand is improving.** According to the Federal Reserve's January 2012 lending survey (4Q11 activity), banks reported stronger demand for C&I loans from firms of all sizes while demand for commercial real estate (CRE) improved modestly. On the household side, demand for credit cards and auto loans increased in 4Q11. However, banks eased their underwriting standards and pricing terms somewhat during the quarter, which may at least partly explain the increase in loan demand.

- **Credit metrics continue to normalize.** Charge-offs and delinquencies are expected to continue their downward trajectory supported by gradually improving employment trends and GDP growth. The pace of improvement, however, will continue to decelerate. As household and business spending picks up and non-bank finance companies grow their loan portfolios, a slight reversal in the credit metric trends could emerge.

20. Average Daily Trading Volumes Mutual Fund Flows (Capital Markets)

**Forecast:** Declining trading volumes and modest mutual fund inflows

- **Trading volumes continue to trend lower.** Average daily trading volumes in January were down 7% compared to 4Q11 and 15% compared to January 2011. In the near term, we expect equity trading volumes to remain soft reflecting the new regulatory environment (i.e. Dodd Frank) and decreased market volatility.

- **Industry flows are off to a positive start in 2012.** According to the Investment Company Institute (ICI), inflows to long-term mutual funds were $35.6 billion in January 2012. This compares to an outflow of $16.6 billion in December and marked the first time since May 2011 that overall flows were positive.

- **Investors continue to prefer fixed income funds.** Inflows into bond funds remain strong, highlighting the risk-averse sentiment among investors. In January, total inflows were $27.9 billion, up from $9.5 billion in December 2011.

- **Equity fund flows remain weak.** Stock funds posted another month of outflows in January although the amount was substantially lower than in prior periods. In January, total outflows were $0.2 billion, down from $28.8 billion in December 2011 and $18.6 billion in November 2011.
21. Premiums, Consideration & Deposits & Net Investment Income (Insurance L/H)

**Forecast:** Modest premium growth and lackluster investment returns

- **Premium growth should return in 2012.** Premiums are expected to grow at a modest pace in 2012 driven by strong growth in retirement products and improved pricing across most products. Sales volumes will benefit from less economic uncertainty and improved consumer balance sheets, but will face pressure from less generous terms and still elevated (although improving) unemployment. However, sales of interest sensitive products (i.e. fixed annuities) will remain challenged given the low interest rate environment.

- **Investment income remains pressured by low rates.** The low interest rate environment remains a key challenge and will continue to put downward pressure on investment income growth. Importantly, insurance companies have remained conservative and have yet to deploy strategies to generate additional yield (and risk) by investing in lower rated securities.

22. Combined Ratio & Net Investment Income (Insurance P/C)

**Forecast:** Improved underwriting results and lackluster investment returns

- **Underwriting losses reflect record CAT events.** P/C insurers' underwriting profitability deteriorated in 2011 reflecting a record number of catastrophe (CAT) events. The industry’s combined ratio soared to 118% in 2Q11 and improved only modestly to 109% in 3Q11. Underwriting results are expected to improve in 2012 primarily reflecting a more normalized number of CAT events.

- **Market pricing has started to improve.** After years of soft pricing, recent poor underwriting results are expected to result in higher renewal rates. According to AM Best, net premiums written are expected to rise 3.8% in 2012 driven by more favourable pricing trends. However, it remains unclear if the shift in pricing will develop into a longer term trend given that the industry is highly competitive and remains well capitalized with excess underwriting capacity.

- **Investment income remains pressured by low rates.** The low interest rate environment remains a headwind, but a greater amount of invested assets is expected to drive modest investment income growth in 2012.

**Note:** The Combined ratio is a primary indicator of P/C insurers’ underwriting profitability. **Calculation:** losses incurred to premium earned plus underwriting expenses to premiums written after policyholders’ dividends.
23. U.S. REIT SS NOI Growth and Vacancy Rates (REITs)

**Forecast:** Positive SS NOI trends and gradually improving vacancy trends.

- **Operating performance continues to recover.** Same store (SS) net operating income (NOI) continued to recover in 2011 supported by improving occupancy and rent growth. However, the improvement remains bifurcated between REIT subsectors with multifamily and self storage outperforming other property types.

- **Vacancy rates are gradually improving.**
  - **Multifamily:** the near term outlook is supported by household formation growth, job creation and the decline in home ownership. However, as the supply of new properties increases the pace of improvement in occupancy and rent growth will slow.
  - **Office:** property fundamentals will remain challenged in the near term reflecting excess supply and economic uncertainty. However, properties located in central business districts will outperform suburban properties.
  - **Retail:** vacancy rates have stabilized but the outlook remains uneven across the sector. Malls and power centers located in desirable locations will outperform strip centers and neighborhood centers.
  - **Industrial:** vacancy trends are expected to gradually improve supported by GDP growth and limited new construction.

24. PC Shipment

**Forecast:** Low mid-single digit growth

- **2012 global PC unit sales are expected to grow low mid-single digits.** As global PC growth has averaged 9% per year over the last 10 years, modest 2012 expectations reflect prospects of economic weakness in the Eurozone, HDD shortages (1H12), tablet share losses and the wrap-up of the enterprise refresh cycle.

- **Offsetting positive growth drivers reflect an easy y/y comparison when compared to flat 2011 results; continued growth in emerging markets; expected demand for ultrabooks in the developed markets; and, an upcoming release of Windows 8.**

- **Industry revenue is pressured by a changing sales mix which reflects demand in faster growing emerging markets for lower priced items.**

- **Asian players including China’s Lenovo are better positioned in the emerging markets because of an advantageous cost structure and geographical proximity.** These dynamics prompted HP to consider exiting the PC business during 2011, however the number 1 player in the PC space ultimately decided to stay in the business. HP’s efforts to stem 2011 share losses could result in 2012 industry price competition.
25. Semiconductor Shipment

Forecast: Low-single digit growth prospects

- 2011 global semiconductor sales grew +0.4% to a record $300B. This reflected the industry’s secular strength offsetting downward cyclical pressure in the form of Japan’s natural disasters, Thailand floods and global economic weakness.
- Over the long-term, we expect the industry will continue to enjoy healthy secular growth drivers as: (1) end-market products increase in chip intensity as manufacturers seek to make their wares more intelligent and networked, (2) manufacturers continue to drive strong end-market demand with innovations in products including smartphones, tablets and other Internet connected devices, and (3) continued chip innovation increases functionality while reducing power consumption and production costs such that semiconductor devices will become even more widely used.
- For 2012, we believe end-market demand will be moderate albeit healthy. However, the industry’s current situation is pressured by excess inventories resulting from a de-acceleration in 2011 sales growth from 2010 levels. Taken together, we expect 2012 global industry growth of low-single digits which is modest when compared to an 11% annual average between 1990 – 2010.

26. Wireless Subscription

Forecast: Mid-single digit growth prospects

- During 2011, aggregate wireless subs (AT&T, VZ, Sprint, T-Mobile, Metro PCS & Leap) grew 5% consistent with 2010 results. Once again, we see growth in lower-cost prepaid subs (+20% y/y during 2011) far outdistancing postpaid sub growth (slightly de-accelerating in 2011 to +2.5% from +3.3% in 2010).
- We believe relatively strong prepaid growth reflects: (1) better prepaid offerings in terms of phones and plans – including smartphone options, national coverage, unlimited usage options; (2) incremental subs in this saturated market tend to be more price sensitive; (3) trade-down from post-paid because of economic challenges; (4) attraction from subscribers with bad credit.
- Industry players seek to convert postpaid subs into higher profit smartphone data customers as industry unit sales continue to mature. To this end, they are investing heavily in LTE 4G technology, additional spectrum and smartphone subsidies (specifically relating to Apple’s iPhone series). We believe these investments will moderate during 2012 as smartphone demand gains momentum on its own.
- We expect 2012 wireless subscriber growth will maintain at the mid-single digit rate. This is based upon strong prepaid growth continuing to offset moderating postpaid growth.
Forecast: Electricity demand to remain weak, wholesale power price pressured

- Electricity demand was down in 2H/11 decreasing 2.4% over 2H/10. Industrial demand was flat, as manufacturing activity failed to gain much traction. Commercial demand dropped as unemployment remained high and tempered consumption. Residential demand dropped as well with a warm winter and due to an anemic housing market.

- Retail sales of electricity will remain depressed as unemployment is expected to stay high and the housing market is projected to stay in the doldrums. This will be balanced, somewhat, by manufacturing activity that is beginning to show signs of life, with expectations of growth in orders and production.

- Wholesale prices will continue to face pressure from low natural gas pricing due to continued shale gas oversupply. Excess generation capacity will continue to elevate reserve margins and further dampen pricing.
Appendix 1: Macro Indicators

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<th>Real GDP Growth</th>
<th>ISM</th>
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<th>Industrial Production</th>
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<th>Consumer Confidence Index</th>
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Appendix 2: Exchange Rate

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<th>British Pound</th>
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<td>![Graph of Euro Exchange Rate] (Source:Bloomberg)</td>
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<td>![Graph of Canadian Dollar Exchange Rate] (Source:Bloomberg)</td>
<td>![Graph of Japanese Yen Exchange Rate] (Source:Bloomberg)</td>
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